THE IMPACT OF THE GLOBAL FINANCIAL CRISIS ON TRANSITION CHANGES IN SERBIA[1]

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Abstract

After more than eight years of implementing transition reforms, the economic environment in Serbia, while showing signs of progress, remains unsatisfactory. The economy of Serbia is facing too many difficulties, which are reinforced by the "spillovers" from the global financial crisis. Nevertheless, the country's economy could rebound in the coming period if certain conditions are met.

Key words: Serbia, Transition Changes, Economic Environment, Global Financial Crisis

1. Introduction

After more than eight years since the transition process started, the economic environment in Serbia, while showing signs of progress, cannot be deemed satisfactory. The Serbian economy is facing numerous problems, which are aggravated by the "spillovers" from the global financial crisis.

An attempt to answer, at least partially, some of the questions relating to the course of the transition in Serbia will be made in this paper. The effects of the transition reforms implemented to date in Serbia and the prospects for ensuring an enabling business environment under unfavourable conditions created by the global financial crisis will be assessed.

2. The transition process and the business environment in Serbia

2.1. Analysis of the transition indicators for Serbia

While the transition process has yielded results, many desired objectives have not been reached. Regrettably, many initial expectations that transition reforms, in particular the privatisation and restructuring of enterprises, would enable a radical improvement of key economic performances have not been met. The belief that reforms would boost economic development is increasingly giving way, as transition losses build up, to a slowdown in reforms and even scepticism that they will create any improvements in the near future.

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[1] This chapter is a part of a research project No. 159004, financed by the Ministry of Science and Technological Development of the Republic of Serbia, named: "The Integration of Serbian Economy into the EU - Planning and Financing of Regional and Rural Development and Enterprise Development Policy" and a part of a survey within a research project called "Integration of Financial Services Sector of the Balkan Countries into European Financial System." as part of interstate programme of co-operation of „Pavle Savić" between the Institute of Economic Science from Belgrade and the University of Nice - Sophia Antipolis from Nice, France.
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According to the criteria that the European Bank for Reconstruction and Development uses in its assessment of transition results [2], Serbia was ranked 12^{th}-17^{th} among nineteen transition economies in Europe in 2008. All countries of the Visegrád Group, the Baltic countries, Eastern Balkan countries and some countries in the Western Balkans (Croatia, Albania and the Former Yugoslav Republic of Macedonia) had a higher ranking than Serbia.

In 2008, Serbia achieved the best results in price liberalisation, then in small-scale privatisation and in trade and foreign exchange liberalisation and, finally, in banking reform and interest rate liberalisation. The least amount of progress was observed in the implementation of a competition policy and in the development of securities markets and financial institutions other than banks. Serbia was relatively slow in long-term structural reforms. The country's average score was 2.89 on a scale of 1 to 4+. Table 1 outlines the results that Serbia achieved in the areas of key importance for the transition process.

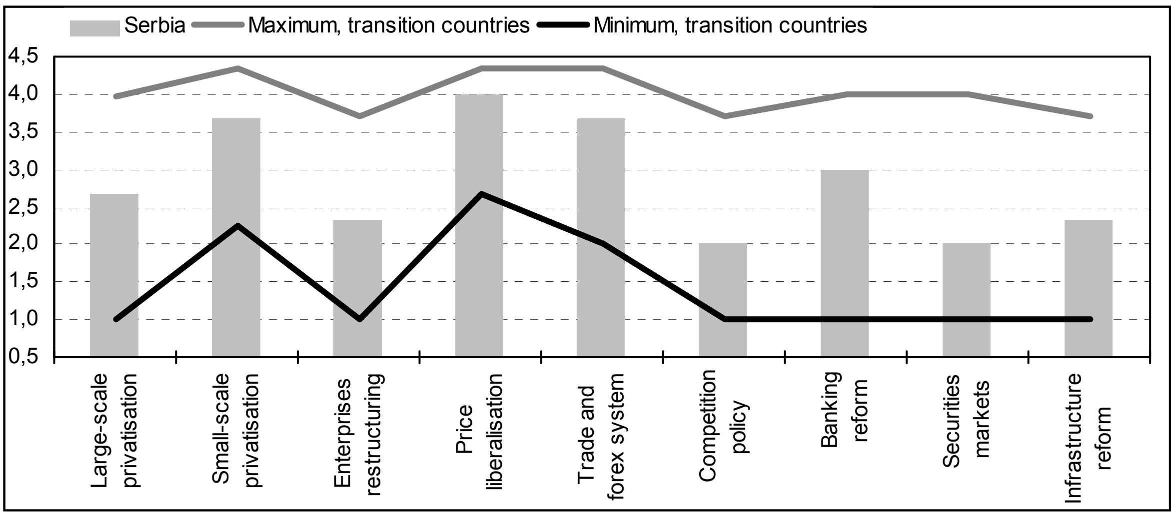
Table 1. Transition indicators for Serbia, 2001-2008

	2001	2002	2003	2004	2005	2006	2007	2008
Large-scale privatization	1.00	2.00	2.33	2.33	2.67	2.67	2.67	2.67
Small-scale privatization	3.00	3.00	3.00	3.33	3.33	3.67	3.67	3.67
Enterprises restructuring	1.00	2.00	2.00	2.00	2.33	2.33	2.33	2.33
Price liberalization	4.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Trade and foreign exchange liberalization	2.67	3.00	3.00	3.00	3.33	3.33	3.33	3.67
Competition policy	1.00	1.00	1.00	1.00	1.00	1.67	2.00	2.00
Banking reform and interest rate liberalization	1.00	2.33	2.33	2.33	2.67	2.67	2.67	3.00
Securities markets and non-bank financial institutions	1.00	1.67	2.00	2.00	2.00	2.00	2.00	2.00
Infrastructure reform	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.33
Average score	1.52	2.33	2.41	2.44	2.59	2.70	2.74	2.89

Source: [2]

The analysis of the pace of transition in Serbia reveals a rather pronounced cyclical tendency. Clear progress in 2002 was followed by a hiatus in 2003 and particularly in 2004, after which the economy recovered to some extent in 2005 and 2006. Then came another pause (in 2007) and another improvement (in 2008).

Figure 1. Position of Serbia among countries in transition, 2008



Source: [2]

In conclusion, the pace of transition reforms in Serbia has been rather slow, in a “stop-and-go” fashion. However, the achieved results can be seen as relatively satisfactory (see Figure 1), especially given the huge delay (ten years) in the implementation of reforms in comparison with many countries in Central and Eastern Europe.

2.2. Comparative analysis of the business environment in Serbia and in Central and Eastern European countries

The business environment in Serbia that emerged as a result of transition reforms is neither too favourable nor too competitive compared with Central and Eastern European countries. The most recent World Bank report on business conditions [9], in which ten ease-of-doing-business indicators are analysed, shows that Serbia ranks low in this respect – Serbia is positioned as 94th among 181 countries.

In terms of the ease of doing business, Serbia lags behind other countries in transition. Serbia ranks below Slovakia (36), Hungary (41), Slovenia (54), the FYR of Macedonia (71), the Czech Republic (75), Poland (76) and even Montenegro (90). It is interesting that Serbia ranks higher than Croatia, even though Croatia is far more advanced in negotiations on accession to the European Union. The rankings of selected countries by specific indicators are given in Table 2.

Table 2. Selected rankings on the ease of doing business, 2009

	Serbia	Macedonia, FYR of	Montenegro	Bosnia and Herzegovina	Croatia	Slovenia	Hungary	Slovakia	Czech Republic	Poland
Starting a business	106	12	105	161	117	41	27	48	86	145
Dealing with construction permits	171	152	167	137	163	69	89	53	86	158
Employing workers	91	125	104	117	146	158	84	83	59	82
Registering property	97	88	123	144	109	104	57	7	65	84
Getting credit	28	43	43	59	68	84	28	12	43	28
Protecting investors	70	88	24	88	126	18	113	104	88	38
Paying taxes	126	27	139	154	33	78	111	126	118	142
Trading across borders	62	64	125	55	97	78	68	116	49	41
Enforcing contracts	96	70	130	123	44	79	12	47	95	68
Closing a business	99	129	42	60	79	38	55	37	113	82
Ease of doing business	94	71	90	119	106	54	41	36	75	76

Source: [9]

The currently unfavourable ranking of Serbia on the ease of doing business results from the following factors:

- Numerous and time-consuming procedures still stand in the way of starting a business in Serbia. It takes 11 procedures and 23 days to start up an enterprise. Serbia’s ranking in this respect is lower than in the previous period, notwithstanding frequent (apparently only declarative) endeavours to improve start-up conditions, especially for small and medium-sized enterprises.
- In dealing with construction permits, an enterprise in Serbia faces 20 procedures that take 279 days. In this regard, Serbia is significantly below the average for Central and Eastern European countries.
- The rigidity of labour regulations is decisive for a country’s ranking in the field of employment, because it has effects on the level of unemployment and the size of the informal sector. However, labour regulations are more rigid in Serbia than in any country of the Visegrád Group.

- Registering property in Serbia requires 6 procedures and takes 111 days. There have been no changes in this respect in the last three years.
- Of all indicators analysed by World Bank experts, Serbia ranks highest on conditions for obtaining credit.
- In protecting investors, Serbia ranks satisfactorily (70), higher than a number of its neighbours: the FYR of Macedonia (88), Bosnia and Herzegovina (88) and especially Croatia (126).
- Serbia has a complex and insufficiently transparent tax system. The number of annual tax payments amounts to 66, meaning that an enterprise spends as many as 279 hours to fulfil its tax obligations.
- Judging by the time needed to export or import, trading across borders is easier in Serbia than in any other country included in Table 2. However, the costs to export are higher only in Montenegro and Slovakia, whereas the costs to import are higher only in Montenegro.
- The efficiency of the Serbian legal system is unsatisfactory. To collect disputed receivables resulting from commercial agreements, an enterprise spends 635 days on 36 procedures, while the average rate of debt collection from insolvent enterprises is a mere 29%.
- The closing of a business in Serbia still takes too much time and resources. The liquidation of an enterprise requires 2.7 years and 23% of bankrupt's assets.

A worrying fact is that World Bank analysts identified in the current report compared with the previous one some improvements in only one area in Serbia – in registering property. In the same period, the FYR of Macedonia implemented reforms in six areas, Bosnia and Herzegovina, Bulgaria and Albania conducted reforms in four areas, whereas Croatia saw reforms in two areas.

3. Key economic developments in Serbia, 2001–2008

In early 2001, after the political changes of October 2000, Serbia embarked on the path of transition and, accordingly, of recovery and reintegration of its economy with the international community. Serbia became a member of all key international organisations (with the exception of the World Trade Organisation) and considerably improved its relations with the EU. However, Serbia remains the only country in the region for which the EU Stabilisation and Association Agreement has still not come into force.

Table 3. Key economic indicators for Serbia, 2001–2008*

	2001	2002	2003	2004	2005	2006	2007	2008
Gross domestic product								
Real value, growth, %	5.6	3.9	2.4	8.3	5.6	5.2	6.9	5.5
Total, million €	12,820.9	16,033.7	17,416.4	19,075.0	20,358.0	23,520.6	29,542.7	34,260.0
Per capita, €	1,708.7	2,137.8	2,328.2	2,555.9	2,736.0	3,173.5	4,002.2	4,651.4
Gross value added by activities, %								
Industry	25.0	24.3	23.2	22.9	22.0	21.7	21.2	20.4
Agriculture	15.8	15.3	14.1	15.5	14.1	13.2	11.4	11.8
Construction	3.8	3.5	3.8	3.7	3.6	3.6	3.8	3.6
Services	55.4	56.9	58.8	57.9	60.3	61.5	63.6	64.2
Volume of production, growth, %								
Industry	0.1	1.8	-3.0	7.1	0.8	4.7	3.7	1.1
Agriculture	18.6	-3.4	-7.2	19.5	-5.0	-0.3	-8.0	8.5
Construction	-5.8	12.7	3.2	9.8	5.8	10.9	18.9	4.9
Volume of services, growth, %								
Tourism	-6.5	0.2	-7.3	-0.6	-2.2	1.4	11.2	0.1
Transportation	9.6	6.9	5.0	4.7	4.6	5.8	6.8	0.4
Communications	25.1	3.6	24.1	26.8	28.6	64.2	43.4	41.3

	2001	2002	2003	2004	2005	2006	2007	2008
Real value of services, growth, %								
Wholesale	0.8	12.2	3.2	24.3	17.0	13.3	16.7	10.3
Retail trade	19.8	23.9	13.8	18.0	26.5	7.7	23.0	5.9
Catering	1.1	0.9	0.1	1.3	-1.7	-7.4	6.0	1.0
Consumer prices (end-year), growth, %								
National classification	43.2	11.9	8.2	13.1	17.1	6.0	12.0	7.9
EU classification							11.0	8.6
Employment (annual average) and unemployment (end-year)								
Employed, thousand	2,101.7	2,066.7	2,041.4	2,050.9	2,069.0	2,025.6	2,002.3	1,999.5
Unemployment rate, %	13.4	14.5	16.0	19.5	21.8	21.6	18.8	14.7
Real value of wages and pensions (annual average), growth, %								
Average net wage	16.5	29.9	13.6	10.1	6.4	11.4	19.5	3.9
Average pension	17.9	16.8	9.7	5.9	4.2	2.9	4.7	14.3
Merchandise trade and foreign direct investments, million €								
Exports	1,922.2	2,201.7	2,442.4	2,831.6	3,608.3	5,102.5	6,432.2	7,428.3
Imports	4,759.2	5,956.8	6,589.3	8,623.3	8,439.2	10,462.6	13,506.8	15,580.5
FDI, net	184.0	502.2	1,205.7	776.6	1,244.6	3,492.2	1,820.8	1,812.1
Foreign currency reserves of the central bank and external debt (end-year), million €								
Reserves	1,320.0	2,175.0	2,840.0	3,117.0	4,935.0	9,025.0	9,641.0	8,160.0
External debt	12,608.8	10,765.9	10,858.4	10,354.7	13,064.3	14,885.4	17,789.0	21,801.0

* Real values imply constant prices; the rates of growth refer to the previous year.

Sources: [3, 4, 6]

Between 2001 and 2008, Serbia recorded high economic growth: the gross domestic product grew at an average rate of 5.4% per annum. Furthermore, economic tendencies improved – as for the curbing of inflation, the growth of exports, increases in salaries and pensions, higher foreign exchange reserves and the inflow of foreign direct investments (see Table 3). The Serbian economy is, however, facing major problems and challenges. These include, in particular, a high trade deficit, a high unemployment rate and an excessively high public spending.

The analysis of key economic indicators for Serbia in the period 2001–2008 points to the following conclusions:

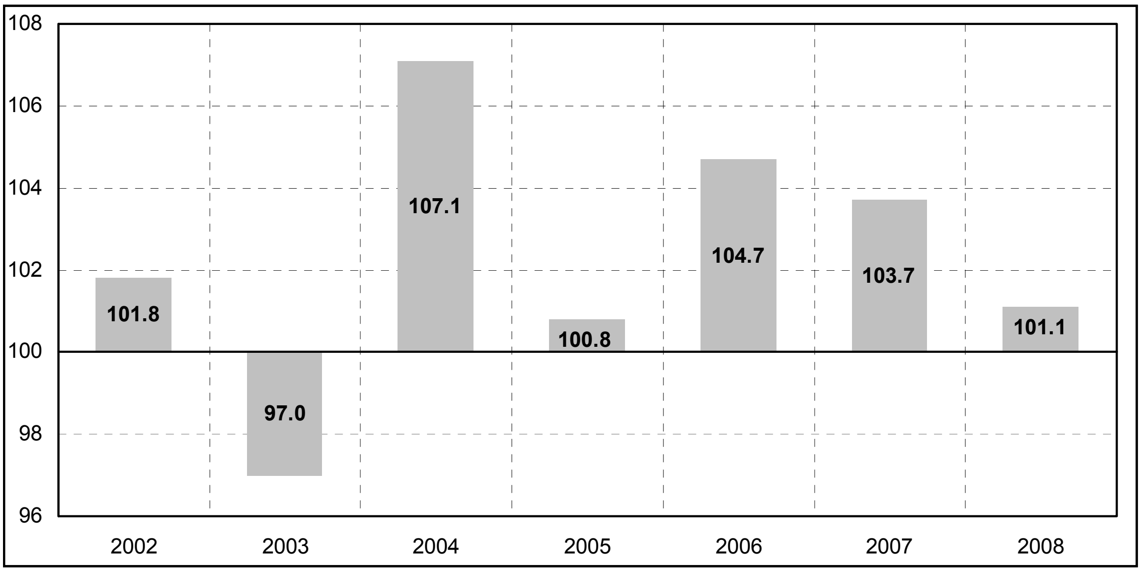
- In Serbia, as in Central and Eastern European countries, the growth of GDP was driven by the growth of the so-called tertiary sector (services), foreign trade, domestic demand and investments (mostly from foreign capital inflow).

Unfortunately, the actual level of GDP in Serbia (34,260 million euros in 2008) is rather modest. Of all transition economies – according to the data released by the Statistical Office of the European Communities [5] – only Bulgaria, with a population size comparable to that of Serbia, has a similar level of GDP (34,118 million euros). Other transition economies have a much higher GDP. Romania, with three times the population of Serbia, has a four times higher GDP (137,035 million euros), while Hungary, with a population which is 36% higher than that of Serbia, has a three times higher GDP (105,843 million euros). Moreover, Croatia, with 40% less inhabitants, has a GDP that is about 40% higher (47,365 million euros), whereas Slovenia, which has a population 3.7 times smaller, generates a GDP about 10% higher (37,126 million euros).

The structure of the Serbian economy is not much different from that of most EU member states. In the structure of the gross value added in Serbia in 2008, services accounted for 64.3%, while industry, agriculture and construction accounted for 20.3%, 11.7% and 3.7%, respectively. A similar structure of the economy, although with a far lower share of agriculture, can be observed in most EU member states. However, the volume of Serbia's real sector is modest, whereas the EU is a rich post-industrial society.

- The growth of "traditional" sectors of the Serbian economy – agriculture and in particular industry – was, on average, much lower than the growth of GDP. Significant oscillations could be observed in industrial production from year to year (see Figure 2), but noticeable improvements did not take place. The Serbian industry is still characterised by obsolete technologies and a production that is largely based on labour-intensive and resource-intensive sub-sectors.

Figure 2. Industrial production of Serbia, 2002–2008: Chain indices



Source: [6]

Transition reforms – primarily those relating to the privatisation and restructuring of enterprises – have been particularly intensive in industry, but they failed to radically increase the volume of production. Experiences from privatisation and restructuring vary greatly, ranging from failure to success.

A large number of privatisations ended in a complete failure. The Privatisation Agency annulled privatisation agreements during the control process in many cases – but most enterprises the privatisation of which had been abolished fell in an even more precarious economic position, with slim chances to recover.

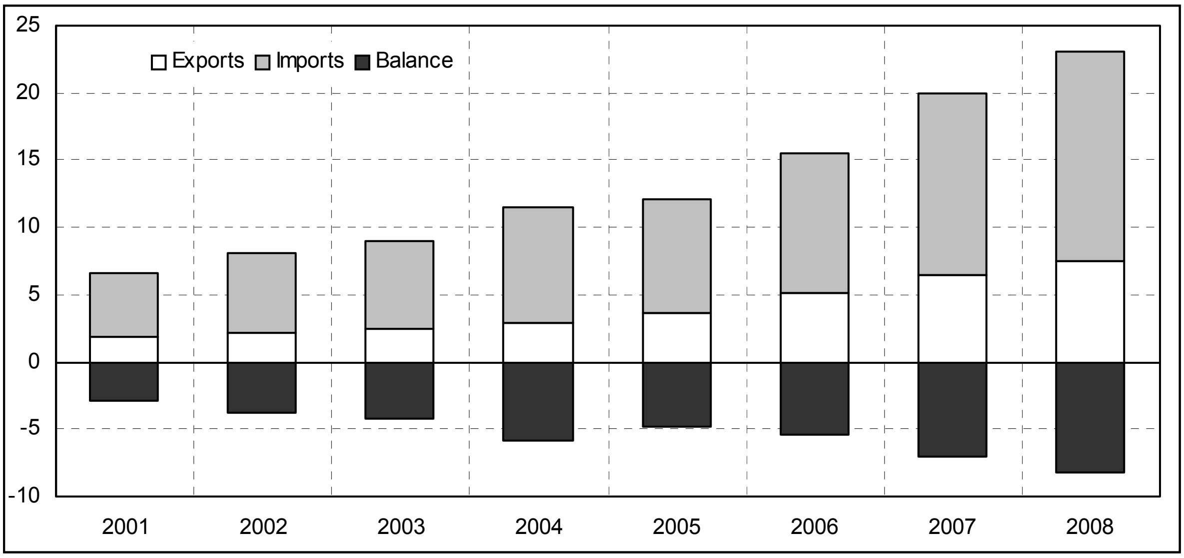
Regrettably, the number of unsuccessful privatisations was even larger. Many of the new owners, often lacking the slightest of competences in the activities of the enterprises they purchased, were unable to improve the way of doing business. Some privatised enterprises underwent changes, usually operational ones, resulting primarily in labour force reduction.

On the other hand, a certain number of privatised enterprises, in particular those acquired by "real" foreign investors, saw major improvements, reflected in a complete change of the business management, in accordance with international standards.

- The volume of merchandise trade has increased considerably. In 2008, merchandise trade accounted for 23,008.8 million euros, which was 3.4 times higher than in 2001 (6,681.4 million euros).

Unfortunately, the growth of merchandise trade stemmed from the growth of imports that permanently and substantially exceeded the growth of exports. This, in turn, resulted in a persistent and increasing trade deficit (see Figure 3). The deficit generated in the last two years – especially in 2008, when it reached as much as 8,152.2 million euros – is not sustainable in the long term and, coupled with enormous public spending, constitutes a major potential source of large-scale macroeconomic instability.

Figure 3. Merchandise trade of Serbia, 2001–2008: Values (billion €)



Source: [6]

While exports have grown significantly, they remain low. The structure of exported goods is also unfavourable. Primary and resource-intensive products (products with little value added, mostly agricultural and mineral inputs) prevail in the structure of exports. A persistent constraint to the growth of exports is the lack of non-price factors of competition: design, brands, standards and the like.

- The results achieved by Serbia in the field of employment leave much to be desired. The expected wave of new employment in the wake of the reform processes has so far failed. New employment has mostly been generated in sectors dealing with non-tradable goods, i.e. in sectors incapable of exporting.

Developments in Serbia's labour market in the transition process have been characterised by lower employment, which was due to privatisation and restructuring in the first place. The total number of the employed declined by 102.2 thousand between 2001 and 2008.

In spite of a negative population growth, Serbia remains a country with high unemployment. In October 2008, the unemployment rate, based on the methodology of the International Labour Organisation, was 14.7% in Serbia – as opposed to 7.3% in the EU [5].

The issue of unemployment and new employment is one of the largest problems faced by Serbia – not only in an economic, but also in a social sense – and this will become even more severe as the economic crisis deepens. It should be pointed out that the growth of food prices is permanently higher in Serbia than in the EU in 2009 over 2008, and that the share of food in the total household expenditure accounts for 35.0% in Serbia – and only 14.5% in the EU [8].

4. The impact of the global financial crisis on economic tendencies and transition changes in Serbia

- In late 2008, the global financial crisis started affecting the Serbian economy. The effects of the external crisis were felt in Serbia not only through the higher cost of money, but also through difficulties to export, owing to the recession in Serbia's largest exports markets, primarily in EU member states. Moreover, foreign-owned banks slowed down their loan activities, taking a much more cautious approach in the new circumstances.

Turbulences in international financial markets impaired the Belgrade Stock Exchange, as well. Late 2008 saw a major decline in the volume of trade and the value of shares in the domestic securities market [1]. Total turnover was 882.5 million euros – 57.2% lower year-on-year. The index of the most liquid shares, Belex15, plummeted by 75.6%. Prices of shares included in the basket of BelexLine index suffered a somewhat smaller decline – 68.7%. Total market capitalisation was 10.3 billion euros – 36.4% lower than a year earlier.

The effects of the global financial crisis became more obvious in the first quarter of 2009, when economic activity in Serbia saw a major decline [6]. Compared with the first quarter of 2008, imports fell by 25.7%, whereas exports fell by 23.8% (the percentages are calculated for amounts in euros). Construction activity (measured as the value of performed works at constant prices) was down by 17%. The decline in the volume of industrial production was almost identical – 16.9%. Retail trade turnover (at constant prices) decreased by 11.7%, while tourism turnover (measured as the number of overnight stays) decreased by 6%. In consequence, the GDP fell by 4.2% in real terms. Furthermore, illiquidity has reached huge proportions, and this may cause the bankruptcy of many enterprises, especially small ones.

Budget revenues have shrunken, prompting a budget revision and steps to ensure new borrowing. In mid May 2009, the International Monetary Fund approved a facility of 2.9 billion euros to build up Serbia's foreign exchange reserves. Shortly after that, large international banks agreed in Vienna to keep the overall level of loan exposure in Serbia.

Measures have also been taken to reduce the risk for financial stability. Government guarantees for savings deposits have increased from 3,000 to 50,000 euros. In addition, incentives for savings and the stock exchange have been introduced. The government abolished the tax on foreign-exchange-savings interest, the tax on capital gains and the tax on the transfer of title to securities. This further reinforced the trust in the overall financial system and preserved the stability of the banking sector. It should be noted that the banking sector in Serbia is sounder than in most transition economies, because of strict regulation and control.

However, in view of the current facts and most likely prospects, projections of key macroeconomic indicators, of which the projection of GDP is always in the limelight, have been revised. Thus, it has been officially estimated that the real GDP in 2009 would fall by 2% – and then by 4%.

The current global financial crisis shook the foundations of the world and of the Serbian economy and will have serious repercussions on economic growth in the coming years. Forecasts of economic tendencies are continuously revised, even by such distinguished institutions as the World Bank. While it is very difficult to predict future economic developments, the following tendencies can be identified as highly probable:

Firstly, economic developments in Serbia in the coming period will be under the dominant influence of the effects of the global financial crisis (which limits the potential for growth) and the resulting global economic environment. Besides, if the EU Stabilisation and Association Agreement does not take effect, the economic situation in Serbia would further deteriorate, as the country would not be able to access certain EU funds and thus compensate for the reduction in foreign capital inflow.

Secondly, the expected decline in exports-driven and domestic demand will result in an economic slowdown. Exports-driven demand is expected to decline because of the economic and trade slowdown worldwide, and particularly in EU countries, on which Serbia mostly depends for exports. On the other hand, domestic demand is expected to decline because of the projected restrictions in both public and private spending and because of lower capital investments that will result from limited access to borrowing abroad and limited inflow of foreign direct investments.

- The negative effects of the global financial crisis have shifted the focus of macroeconomic policy from the monetary to the fiscal sphere, i.e. they have reaffirmed the role of the public sector and of budget management. Considerable effort will be required to cut soaring public spending. However, the role of the government should not be reduced to expenditure control and downsizing. The government needs to become more actively involved in the economic life, and not just by creating an economically enabling and legally reliable business environment. Its efforts should also be focused on providing incentives for agriculture development and for investments in infrastructure (particularly in Corridor 10), ad hoc involvement to salvage large enterprises from bankruptcy (especially exporters and those that employ many workers), providing incentives for exports, and also implementation of various non-tariff measures of protection (those permitted by the WTO).

Monetary policy will remain focused on curbing inflation (at the level below 10%) and providing macroeconomic stability. Accordingly, a highly restrictive monetary policy can be expected to remain in place. However, certain adjustments to the new situation need to be made in this field. Interest rates in Serbia are still too high, much higher than in other countries in the region. Lowering interest rates (primarily the reference interest rate) could be a crucial step towards improving the competitiveness of Serbian enterprises in the global market and boosting economic growth.

Adverse developments in international financial markets, compounded by the unfavourable investments risk rating given to Serbia, will have negative effects on domestic financial markets. It therefore seems reasonable to expect even an absence of portfolio investments, a reduction in the volume of financial market transactions, a lower share of foreign investors in the total stock exchange turnover, a slowdown of foreign loan inflows and lower foreign exchange reserves.

Sales conditions in foreign and domestic markets will become worse in the coming period. The global financial crisis and lower global demand are expected to result in lower exports, especially of some leading sectors (e.g. the metal sector). The pressure of imports supply on the domestic market will increase. Coupled with the expected restrictive policy of commercial banks and insufficient competitiveness of the Serbian economy, this could lead to a production crisis and, possibly, to mass redundancies. In view of this, industrial production is expected to be about 15%-18% lower in 2009 than in 2008. Furthermore, in 2009 both exports and imports are expected to decline by at least 25% compared with 2008.

High unemployment will remain a key issue. In 2009, employment is expected to decline by 0.5% to 1%.

After nineteen years of privatisation according to various models and under different regulations, this process should finally be completed. Privatisation is not an end in itself. It is the key means of transition towards a market economy, i.e. it should enable efficient corporate governance and technological modernization of production, higher exports and improved overall efficiency and effectiveness of doing business. Regrettably, privatisation is often seen in Serbia as the sale of the “family silver” to foreigners [7]. It is frequently associated only with tycoons, illegal accumulation of wealth, theft, the acquisition of property at “preferential” prices, lay-offs and the like. While numerous anomalies have been registered during the privatisation process in Serbia, it appears that the privatisation process has nevertheless had positive effects on economic tendencies and on business efficiency. It is worth remembering that privatisation is only the first step on the long path of reforms that should ultimately improve the overall competitiveness.

The transition reforms in Serbia have not produced the desired changes – improved business efficiency, economic recovery, renewal of economic potentials and new productive employment. The transition process turned out to be more complicated and longer than initially anticipated. Many circumstances were disregarded in the original analysis, including the issue of how transition economies would respond to cyclical tendencies, in particular recessions and crises.

The current global financial crisis generates additional problems, which hinder the process of necessary transition reforms. Namely, in the new circumstances – characterised by recession, deepening of macroeconomic imbalances and sharpening of social tensions – other problems are taking centre stage, and this will not have positive effects on the implementation and pace of transition reforms.

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